WORLDCOM

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February 6, 2002

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Mr. William Caton
Acting Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: CC Docket No. 02-7: Application by Verizon for Authorization to Provide In-Region InterLATA Services in Vermont

Dear Mr. Caton:

Enclosed are WorldCom's Comments in the above proceeding, one of which contains confidential information. The confidential version and a redacted version of the document are being submitted with appropriate cover letters with the understanding that the confidential material will be fully protected by the Protective Order established specifically for this docket (CC Docket No. 02-7; rel. January 17, 2002) and that the requirements for review and use of this document will be fully satisfied.

Please call me with any questions.

Sincerely,

Lori Wright

Lori Wright
Associate Counsel
Federal Advocacy

Enclosure

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of Application by Verizon New England Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a/ Verizon Enterprise Solutions), Verizon Global Networks Inc., and Verizon Select Services Inc., for for Authorization to Provide In-Region, InterLATA Services in Vermont	)	CC Docket No. 02-7

COMMENTS OF WORLDCOM, INC. ON THE APPLICATION BY VERIZON FOR AUTHORIZATION TO PROVIDE IN-REGION, INTERLATA SERVICES IN VERMONT

Robert Lopardo
Lori Wright
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February 6, 2002

INTRODUCTION AND EXECUTIVE SUMMARY

Verizon's section 271 application for Vermont should be rejected because its UNE rates far exceed TELRIC levels and because a price squeeze prevents the development of competition in the state. Verizon defends its UNE rates in Vermont by comparing them to now-defunct UNE rates in New York. But within days after Verizon filed its Vermont application relying on this benchmarking claim, the New York Public Service Commission (New York PSC) announced a long-expected decision to significantly reduce UNE rates in New York. Verizon's switching rates in Vermont are now more than double the new New York rates. The New York comparison now powerfully suggests the extent to which Verizon's Vermont rates exceed any conceivable TELRIC figure.

Unable to rely on any benchmarking arguments, Verizon's rates now must rise or fall on the Vermont cost study on which they are based. But Verizon did not even bother to put that cost study on the record here, no doubt because it was infected with errors that would merely serve to further discredit the rates. Although difficult to ascertain exactly why Verizon's switching rates are so high given the truncated "summary" of the cost study Verizon does provide, a few fundamental errors are quickly apparent. First, as it has done in Massachusetts, New York, and New Jersey, Verizon likely used in Vermont only the minutes for workdays to determine the per-minute switch usage rates, which it nonetheless applies to weekends and holidays. This simple arithmetic error in the past has accounted for substantially inflated rates, as both the New York PSC and the Massachusetts DTE concluded in rejecting Verizon's approach. Second, Verizon apparently further increases the switching costs of CLECs by charging its inflated switching rate twice for intra-switch calls, even though an intra-switch call passes through the switch only once. This "double-charging" for intra-switch calls has no justification and also was explicitly rejected in both New York and Massachusetts. This error likely accounts for a significant increase in the switching rate. It should be rejected for Vermont as well.

Because its switching rates are so far above its costs, Verizon's rates create a price squeeze that makes competition impossible in the residential market in Vermont. As a result, as well as failing to comply with the competitive checklist, granting Verizon's application would also disserve the public interest. Until its switching rates are reduced to TELRIC and the price squeeze eliminated, Verizon's application for Vermont must be denied.

TABLE OF CONTENTS

TABLE OF ATTACHMENTS

TAB	DECLARANT	SUBJECT
A	Declaration of Vijetha Huffman	Pricing

TABLE OF CITATION FORMS

FCC Orders	
Kansas-Oklahoma Order	In re Application of SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance for Provision of In-Region, InterLATA Services in Kansas and Oklahoma, CC Docket No. 00-217, Memorandum Opinion and Order, 16 F.C.C.R. 6237 (2001), aff'd in part and remanded, Sprint Communications Co. v. FCC, 274 F.3d 549 (D.C. Cir. 2001).
Michigan Order	In re Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Michigan, CC Docket No. 97-137, Memorandum Opinion and Order, 12 F.C.C.R. 20543 (1997).
Declarations and Affidavits	
Frentrup Decl.	Declaration of Chris Frentrup on Behalf of WorldCom (Tab B to Application by Verizon for Authorization Under Section 271 of the Communications Act to Provide In-Region, InterLATA Services in the State of New Jersey, CC Docket No. 01-347 (FCC filed Jan. 13, 2002)).
Huffman Decl.	Declaration of Vijetha Huffman on Behalf of WorldCom (Tab A hereto).
McCarren/ Garzillo/Anglin Decl.	Joint Declaration of V. Louise McCarren, Patrick A. Garzillo, and Michael J. Anglin on Behalf of Verizon (App. A, Tab D to Verizon Application).
State Commission Orders	

New York PSC Order	Proceeding on Motion of the Commission to Examine New York Telephone Company's Rates for Unbundled Network Elements, Case No. 98-C-1357 (New York PSC Jan. 28, 2002).

Before the
Federal Communications Commission
Washington, D.C. 20554

Application by Verizon New England Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a/ Verizon Enterprise Solutions), Verizon Global Networks Inc., and Verizon Select Services Inc., for for Authorization to Provide In-Region, InterLATA Services in Vermont	)	CC Docket No. 02-7

COMMENTS OF WORLDCOM, INC. ON THE APPLICATION BY VERIZON FOR AUTHORIZATION TO PROVIDE IN-REGION, INTERLATA SERVICES IN VERMONT

Verizon's switching rates in Vermont are well outside the range of rates a TELRIC study could reasonably produce. The cost study upon which the rates are based is so indefensible that Verizon does not even put it on the record here. Verizon defends its rates by stating that they are proportionately below the 1997 New York rates, taking into account the differences in underlying costs in the two states. But after Verizon filed this application, the New York Public Service Commission substantially reduced those rates. As a result, Verizon's switching rates in Vermont are now more than double the new switching rates in New York, and Verizon's benchmarking claims are no longer valid. To the contrary, the comparison to New York rates that Verizon urges now makes clear that Verizon's Vermont switching rates are well above cost. Verizon can no longer argue that outdated, non-TELRIC rates in New York justify excessive rates in Vermont. Accordingly, Verizon has not proved compliance with checklist item two, 47 U.S.C. § 271(c)(2)(B)(ii), which imposes on Verizon the burden of proving that it has made available unbundled network elements at just, reasonable and non-discriminatory prices based on the costs of the elements. Additionally, Verizon fails to meet the public interest test, 47 U.S.C. § 271(d)(3)(C), since rates this high create a price squeeze that make competition impossible in Vermont's residential market.

I. NEW YORK UNE RATE IMPROVEMENTS HIGHLIGHT PRICING DEFICIENCIES IN VERMONT

A. Verizon's Vermont Switching Rates Are Improper.

Verizon defends its switching rates by stating that they are proportionate to the rates established in New York and found by this Commission to be within the TELRIC range. Verizon can no longer maintain this "benchmarking" defense of its rates.

In defending its UNE rates in this application, Verizon relies on a combination of a cost study completed in 2000 that has not been submitted in this docket and on a comparison of its Vermont rates to rates in New York. Vermont Brief at 81-87. Verizon chose to rely on New York rates, even though it understood that those New York rates were subject to imminent revision. Evidently it was hoping that this application would be resolved before new rates were adopted, or that the new rates would not be significantly lower than the existing New York rates. Verizon has now lost its gamble that the New York rates would not be reduced. On January 28, 2002, the New York PSC issued an order cutting by approximately one-half New York's switching rates.[1] This Commission has made it clear that once New York lowered its rates, the old rates could no longer be relied upon to make a "benchmarking" claim in any other state. "If the New York Commission adopts modified UNE rates, future section 271 applicants could no longer demonstrate TELRIC compliance by showing that their rates in the applicant state are equivalent to or based on the current New York rates, which will have been superceded." Massachusetts Order ¶ 29. Simply put, as things now stand, the Vermont rates must stand or fall on their own merits.

Indeed, given that the new New York rates are approximately one-half the switching rates in Vermont – even though the cost of switching does not vary significantly across the states, especially states in the same region – comparisons to New York now powerfully demonstrate that the Vermont switching rates are not cost-based.

Verizon likely will assert that it should get by on a technicality and be permitted to rely on the old New York rates. We anticipate two arguments in support of this position: first, that under the "complete-when-filed" rule, the rates constitute a change that occurred after its application was filed and therefore may be ignored; and second, that the now-abandoned New York rate was never found to be explicitly unlawful and therefore may be relied on. These arguments do not have merit.

First, the "complete when filed" rule applies to the showing the BOC must make when it files its application, and does not limit the kind of evidence commenters can introduce to oppose

1 The precise amount of the reduction will not be known until an appropriate compliance filing is approved by the New York PSC.

the application. At the BOCs' request, the Commission has considered as part of its decision-making in section 271 proceedings changes in UNE rates that take place while a section 271 application is pending. The same policy fully applies here. Here, as the Commission stated in the Kansas/Oklahoma section 271 proceeding, "the rate changes at issue are quite limited in nature . . . . As a result, addressing the effect of these rate revision in terms of compliance with section 271 places a limited additional analytical burden on the Commission staff and commenting parties." Kansas-Oklahoma Order ¶ 23. Indeed, because the only relevant question here is whether the old New York rates have been superceded, it places no burden whatsoever on Commission staff to observe that they have, in fact, been superceded. Additionally, just as in the Kansas/Oklahoma proceeding, the situation here "differs significantly from the consideration of promises of future action, which may or may not take place." Id. Nor do the new New York rates constitute a change of law – rather, the <u>factual</u> predicate of one of Verizon's legal arguments has been eliminated. It would be arbitrary and capricious for the Commission to act as though the factual predicate still exists.

Second, Verizon may argue that the old rates still may be relied on because the New York PSC did not formally state that the old rates were not TELRIC-compliant. But the question is not whether it was reasonable to believe that the rates were TELRIC when they were adopted in 1997, but whether it is reasonable to rely on those rates in 2002 given what is now known about switching costs. In any event, the New York PSC did formally state that its initial decision "rested in large part" on the single most important input used to calculate the cost of switching –

the amount paid for switches. The New York PSC's stated that its initial decision rested in large part on false statements by Verizon that it did not routinely receive deep discounts when it purchased switches. The rates in the New York PSC's new order were set without relying on the above-described false information and as a result are cut nearly in half. Verizon cannot plausibly argue that the old rates fall within a range of results that TELRIC would produce if correct inputs were used.

B. VERIZON HAS INTRODUCED NO EVIDENCE ON THE RECORD TO ESTABLISH THAT ITS SWITCHING RATES ARE TELRIC.

Unable to rely on any benchmarking to win approval, Verizon must rely on other evidence to establish that its switching rates are within the TELRIC range. But Verizon has put all of its eggs in the benchmarking basket -- it has not even introduced the cost-study that allegedly supports its excessive switching rates. The Commission has specifically stated that it expects "a BOC to include in its application detailed information concerning how unbundled network element prices were derived." Michigan Order ¶ 291 (footnote omitted). Rates cannot be proved to be "based on cost" unless there is some way to compare those rates with the BOC's underlying network costs. Verizon has submitted no costs studies as part of the instant application. We have no doubt that if Verizon did introduce this study, it would be possible to identify the clear errors that led to such an insupportable result. Indeed, Verizon's refusal to introduce the cost study speaks volumes about its ability to defend it.

Instead of providing the actual cost model, Verizon provides "broad outlines of the model used to derive costs."[2] Even from this wholly inadequate summary, some of the errors that led to the high costs are suggested. Verizon apparently repeats the error it makes in other section 271 applications (e.g., New York, Massachusetts, and New Jersey applications) of using only the minutes for workdays to determine the per-minute switch usage rates, which it nonetheless applies to weekends and holidays and improperly charges twice for intra-switch calls. In other words, Verizon determines the size of the switches needed based on peak usage for the switches and then applies a busy hour to total usage ratio to determine the total minutes that will be divided into the switch cost to determine the switch rate. However, after obtaining the average daily usage in this manner, Verizon then multiplies that usage by only 251 days, which is the number of weekdays, less holidays, in a year. This methodology for determining the number of minutes in a year effectively assumes that there are no minutes of calling on the weekends or on holidays, but then Verizon charges CLECs for weekend and holiday usage. Using only peak minutes to set switching rates is a clear violation of the TELRIC methodology, which requires that all usage be considered in determining rates. Indeed, this very error infected Verizon's proposals in New York, where the state commission concluded that "Verizon's calculations do not calculate that ratio properly and have the effect, Verizon's arguments to the contrary notwithstanding, of spreading switching costs over only business day MOUs, not total MOUs." New York PSC Order at 38. Even the very conservative assumption that usage on non-peak

2 McCarren/Garzillo/Anglin Decl. ¶ 31.

days is only half the level of usage on peak days means that the switch usage rates should be 18.5 percent lower. WorldCom New Jersey Comments, Frentrup Decl. ¶ 12, n.1. If Verizon is using the above-described methodology, the Commission should require Verizon to correct this clear error by reducing Verizon's switch usage rates to reflect usage on all 365 days of the year, or, alternatively, to offer switching usage at a zero rate in off-peak periods, before it grants section 271 authority to Verizon. Id.

Verizon further increases the switching costs of CLECs by charging its inflated switching rate twice for intra-switch calls -- one charge for originating and one charge for terminating -- even though an intra-switch call passes through the switch only once. The cost of switching an intra-office call does not differ from the cost of switching only the originating portion of an inter-office call, where one switching charge applies. This "double-charging" for intra-switch calls has no justification and was explicitly rejected in both New York and Massachusetts. It should be rejected for Vermont as well.

II. VERIZON'S ENTRY INTO VERMONT'S INTERLATA MARKET WOULD NOT BE IN THE PUBLIC INTEREST.

Because the switching rates are so high above any conceivable TELRIC rate, they create a price squeeze that makes residential competition impossible in Vermont and that makes it contrary to the public interest to grant this application. The U.S. Court of Appeals for the District of Columbia Circuit recently made clear in Sprint Communications Co. v. FCC, 274 F.3d 549 (D.C. Cir. 2001), when remanding the Commission's Kansas-Oklahoma section 271 order, that under the Act's public interest test the Commission must carefully consider whether the applicant's UNE rates create an anticompetitive price squeeze that prevents local competition. As discussed below, and in the accompanying Declaration of Vijetha Huffman, that is precisely the case in Vermont, which has enabled Verizon to continue its monopoly domination of the residential market.

Even a CLEC selling local residential service for the same price as Verizon would not make nearly enough money to pay for the cost of the elements it leases to provide the service and its own internal costs.[3] Huffman Decl. ¶ 9. The statewide gross margin is $4.28 in Vermont, meaning that on average a CLEC would lose approximately $6.00 on every customer every month after covering its internal costs of more than $10 per line each month. Id. Even in the most favorable zone, the metro zone, the gross margin between a CLEC's revenues and telco costs using UNE-P would be $9.49 per line each month, which is not sufficient to cover a company's internal costs. Id. The gross margin in the suburban zone is only $8.86, and then drops to <u>negative</u> $4.42 in the rural zone – all before a CLEC covers any internal costs. Id. This is inconsistent with the public interest and is grounds for denial of the application.

CONCLUSION

Verizon's Vermont application should be denied.

Respectfully submitted,

Robert Lopardo
Lori Wright
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Washington, D.C. 20036

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February 6, 2002

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3 Also contributing to the price squeeze in Vermont are the excessive DUF charges of $0.91 (as compared to the new DUF charges in New York, which we expect to be approximately $0.22) and the high loop rates in the rural zone. See Huffman Decl. ¶¶ 7, 9.

CERTIFICATE OF SERVICE

I, Vivian Lee, do hereby certify that copies of the foregoing Comments of WorldCom, Inc. were sent via hand delivered (as indicated) or e-mailed to the following on this 6th day of February, 2002.

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Common Carrier Bureau
Federal Communications Commission
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Washington, DC 20554

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____
Vivian Lee

TAB A

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of Application of Verizon New England for Authorization to Provide In-Region, InterLATA Services in Vermont	)))))))	CC Docket No. 02-7

**DECLARATION OF VIJETHA HUFFMAN
ON BEHALF OF WORLDCOM, INC.**

Based on my personal knowledge and on information learned in the course of my duties, I, Vijetha Huffman, declare as follows:

1. My name is Vijetha Huffman. I am Senior Manager of Local Business Development for the Mass Markets Division of WorldCom. I am responsible for financial planning, business analysis, and new market development in support of WorldCom's entry into the residential local business. This includes evaluating the financial viability of providing residential local service in markets that WorldCom has not yet entered and determining price changes necessary for WorldCom to enter. I have worked for WorldCom (and its predecessor MCI) for 6 years in a number of finance positions.

2. The purpose of my declaration is to explain why local service is critical to WorldCom's business plans for the residential market and how Vermont's network element pricing prevents competitors from providing local service in the state.

I. LACK OF MARKET ENTRY IN VERMONT VIA UNE-P

3. WorldCom would like to serve a broad range of customers in Vermont and other states, offering a package of services to the mass market that includes local service. WorldCom is unable to enter the local residential market in Vermont, however, because of Verizon's extraordinarily high prices for switching, as well as its high DUF charges and loop rates in the rural zone.

4. A strong local presence is essential to WorldCom's competitive success in providing service to residential customers. Many residential customers are seeking fully integrated telecommunications services, including local, long distance, and Internet access. Customers also seek the opportunity to benefit from new and innovative products and to save money on their telephone bills. Thus, the ability to profitably offer integrated products is critical to WorldCom's plans to respond to the needs of its existing long distance customer base and to attract new customers.

5. UNE-P, the combination of all unbundled elements necessary to provide local service, is the only service-entry vehicle that WorldCom uses to offer local residential service, and it is the only service-delivery option that WorldCom currently views as even potentially viable. The UNE-P mode of entry provides WorldCom with greater flexibility than resale to offer innovative products and permits much faster and more pervasive market entry than a pure facilities-based offering. Moreover, when UNE prices are truly set at cost-based rates, CLECs generally can compete profitably with the ILECs. Where barriers to entry such as anti-competitive pricing and discriminatory OSS are eliminated, WorldCom will use UNE-P to enter residential markets.

6. UNE-P is the means that WorldCom uses to provide local residential service in a growing number of states in which conditions permit entry in at least some part of the state, and now

includes New York, Texas, Pennsylvania, Michigan, Illinois, Georgia, very limited parts of Florida, and California, where WorldCom provides a limited service offering. In addition, we have just begun offering local residential service in Ohio. It is notable that WorldCom has entered many states that have not been granted section 271 authority (Michigan, Illinois, Ohio, Georgia and Florida), and of the entry states that have been granted authority (New York, Pennsylvania and Texas), WorldCom entered well before section 271 authority was granted, sometimes by more than a year. On the other hand, section 271 approval has not caused WorldCom to enter just any state: WorldCom has not entered Massachusetts, Kansas, Oklahoma, Missouri, Arkansas, or Connecticut.

II. PRICE SQUEEZE IN VERMONT

7. WorldCom generally will not sell services unless it believes it can do so profitably. WorldCom cannot offer local service in Vermont due to the high switching costs in the state, as well as the high loop rates in the rural zone and high DUF charges statewide.

8. As seen in Attachment 1 hereto, there are three zones in Vermont -- metro, suburban, and rural. Attachment 1 demonstrates the monthly revenue a carrier would receive if it provided a standard measured product, one feature at the same retail price Verizon charges, and the SLC. Subtracted from the total revenue are the "telco" costs, or, in other words, the costs of the leased unbundled network elements. From that amount, i.e., the gross margin, a carrier must then cover its own internal costs. Internal costs typically include customer service costs, costs associated with customers who don't pay their bills, billing and collections, overhead, marketing costs, and other operational costs, and exceed $10 per line per month, even apart from significant up-front development costs.

9. WorldCom cannot sell basic residential service in Vermont using Verizon's

facilities because there is a price squeeze in all three of the state's zones, as shown in Attachment 1. The principal driver of this price squeeze is Verizon's extremely high switching rates. The statewide average switching rate (including usage, transport, and port) in Vermont is \$13.77. This is approximately double the new switching rate recently announced in New York by the New York Public Service Commission, by our calculations. It is also about double the switching rate in any state that has received section 271 authority (except for Massachusetts, which relied on the just-reduced New York rate) and any state where WorldCom has entered the local market. These switching rates result in unprofitable gross margins in the amount of \$9.49 in the metro zone, \$8.86 in the suburban zone, and <u>negative</u> \$4.42 in the rural zone, which does not cover ongoing costs in any zone much less the up-front development costs, which have a bigger impact in a smaller state. The statewide average gross margin is only \$4.28, meaning that on average a CLEC would lose over \$6.00 on every customer every month once it covers its internal costs. Also contributing to the price squeeze are the high loop rates in the rural zone at \$21.63 and the high DUF charges statewide at \$0.91.

10. Internal CLEC costs of more than \$10 that must be covered by the gross margin are largely comprised of elements over which a CLEC has little control. The single largest cost is for customer service and credits, which amount to *** *** per month per line. Customer service costs include all costs of servicing the customer, including: answering questions when customers call; providing trouble support, such as if a line is not working; performing account maintenance functions; and issuing customer service credits. This cost is largely driven by the extent of customer problems and questions, which can be greatly increased by an incumbent's poor provisioning of UNE-P service, over which the CLEC has no control.

11. A second large internal cost results from customers who do not pay their bills, which amounts to *** *** per month per line, based on our 2001 experience of the percentage of bad debt in New York, as applied to projected Vermont revenues. Due to the importance of local phone service, state commissions closely regulate the process for cutting off service to those who refuse to pay their bills, which limits the extent to which CLECs can avoid bad debt costs.

12. Another internal costs is billing and collections at *** *** per month per line, which includes sending out initial bills, sending letters to customers who do not pay, and other collection activities. In addition, there are sales and acquisition costs, which vary from market to market based on the effort undertaken and results realized. Notably, overhead only amounts to *** *** per month per line.

13. To achieve residential competition in Vermont, Verizon must reduce its very high switching prices, which are significantly out of line compared to the switching rates in most other states and prevent local entry by competitors, as well as its rural loop rates and DUF charges. This concludes my declaration on behalf of WorldCom.

I declare under penalty of perjury that the foregoing is true and correct. Executed on February 6, 2002.

2/6/02

Vijetha Huffman

Vermont - Verizon (by zone)

	State	Metro	Suburban	Rural
Households (000)	197	34	94	70
Density	100%	17%	48%	35%
Local Revenue (1)	$29.70	$29.70	$29.70	$29.70
Access Revenue	$2.20	$2.20	$2.20	$2.20
Total Revenue	$31.90	$31.90	$31.90	$31.90
Switch Port	$1.03	$1.03	$1.03	$1.03
Loop	$12.94	$7.72	$8.35	$21.63
UNE Switching and Transport	$12.74	$12.74	$12.74	$12.74
DUF Charge	$0.91	$0.91	$0.91	$0.91
Total Telco (2)	$27.62	$22.40	$23.03	$36.31
Gross Margin	$4.28	$9.49	$8.86	($4.42)

1 Line fee reflects standard measured product, additional usage of $3.10 above allowance, one feature (call waiting @ $3.25), and SLC.

2 Does not include NRC.

Note: Analysis does not include MCI or other CLEC internal costs (e.g., billing, customer service, sales/acquisition, bad debt)